

The CFTC Adopts Comprehensive Amendments to Its Bankruptcy Rules

February 2, 2021

Background

The Commodity Futures Trading Commission (CFTC) recently adopted final amendments to Part 190 of the CFTC's regulations (the "Final Rules"), governing bankruptcy proceedings with respect to commodity brokers.¹ The Final Rules represent the first comprehensive update to the CFTC's bankruptcy rules since the Part 190 rules were initially adopted in 1983. Approved unanimously, the Final Rules serve to modernize and revise the CFTC's regulations to reflect changes in the commodity brokerage industry over that time.

Subchapter IV, chapter 7 of the Bankruptcy Code ("Code") sets out the essential provisions governing the liquidation of a commodity broker in bankruptcy. However, the CFTC is authorized under section 20 of the Commodity Exchange Act (CEA), "notwithstanding the Code," to adopt rules that provide, among other things: (1) that certain cash, securities, other property or commodity contracts are to be included in or excluded from customer property or member property; and (2) the method by which the business of such commodity broker is to be conducted or liquidated after the date of the filing of the petition under the Code. Part 190 of the CFTC's regulations are promulgated under this authority as well as the CFTC's general rulemaking authority under section 8a(5) of the CEA.

Since the initial adoption of the Part 190 rules, there have been significant developments in practices with respect to commodity broker bankruptcies, including as a result of judicial decisions and certain high-profile bankruptcies (like that of MF Global Inc. and Peregrine Financial Group Inc.). As emphasized in former Chairman Heath Tarbert's statement in support of the Final Rules, they seek to clarify and codify key principles and approaches or practices that have developed over time as the existing Part 190 rules were applied to real-world bankruptcy situations.

Highlights of the Final Rules

At a high level, the Final Rules address the following major topics:

Statutory Authority, Organization, Core Concepts, Scope and Construction. The Final Rules adopt new CFTC Rule 190.00, which sets forth the statutory authority, organization, core concepts, scope and rules of construction for Part 190 of the CFTC's regulations. In particular, new CFTC Rule 190.00 sets out the CFTC's intent regarding bankruptcies for the benefit of market participants, trustees and the general public.

¹ The Final Rules will be codified at 17 C.F.R. §§ 190.00 *et seq.* A voting draft of the Final Rules is available on the CFTC's website at <https://www.cftc.gov/media/5511/FederalRegister120820b/download>. For purposes of this advisory, a "commodity broker" is defined to mean either a futures commission merchant (FCM) or a derivatives clearing organization (DCO) registered as such with the CFTC.

Default of a Derivatives Clearing Organization. The Final Rules adopt new Subpart C to Part 190 of the CFTC's regulations, which governs the bankruptcy of a DCO. Among other things, new Subpart C provides that the trustee should follow, to the extent practicable and appropriate, the DCO's pre-existing default management rules and procedures and recovery and wind-down plans that have been submitted to the CFTC. These rules, procedures and plans will, in most cases, have been developed pursuant to Part 39 of the CFTC's regulations, subject to CFTC staff oversight. This approach relieves the trustee of the burden of developing, in the moment, models to address an extraordinarily complex situation.

Priority of Customers and Customer Property. The Final Rules clarify that shortfalls in segregated property should be made up from the general assets of the FCM. The Final Rules also clarify that, with respect to customer property, public customers are favored over non-public customers.

Securities Investors Protection Act (SIPA) and Federal Deposit Insurance Corporation (FDIC). The Final Rules confirm the applicability of Part 190 of the CFTC's regulations in the context of an FCM that also is registered with the Securities and Exchange Commission (SEC) as a broker-dealer and subject to a proceeding guided primarily by the SIPA. Likewise, the Final Rules clarify the applicability of Part 190 in the context of a proceeding in which the FDIC is acting as receiver.

Letters of Credit as Collateral. The Final Rules confirm the treatment of letters of credit used as collateral. Specifically, the Final Rules make clear that customers posting letters of credit as collateral will be subject to the same pro rata loss as customers that post other types of collateral, such as cash and securities, both during business as usual and during bankruptcy. The pro-rata loss would be calculated based on the face value of the posted letter of credit, even if only a portion was drawn down by a customer at the time of the bankruptcy.

Greater Trustee Discretion. The Final Rules grant trustees greater discretion by, among other things, permitting the trustees to treat public customers on an aggregated basis. This greater discretion generally favors the cost effective and prompt distribution of customer property over the precision of valuing each customer's entitlements on an individual basis.

Transferring Rather Than Liquidating Customer Positions. The Final Rules further confirm the CFTC's longstanding preference for transferring positions of public customers rather than liquidating the positions.

Reflect Changes to CFTC's Regulatory Framework. The Final Rules update Part 190 of the CFTC's regulations to better reflect changes to the CFTC's regulatory framework over the years, including the CFTC's recent revisions to its customer protection rules. The Final Rules also update cross-references to other CFTC rules.

Changes in Technology. The Final Rules also reflect changes in technology, including a recognition that many records are captured and stored electronically rather than on paper.

Non-Substantive Clarifications. The Final Rules provide non-substantive changes to clarify language in the CFTC's regulations. These clarifications are intended to address ambiguities that have complicated past bankruptcies.

A chart summarizing all of the provisions in the Final Rules is available in this advisory's appendix.

Effective Date of the Final Rules

The Final Rules are effective 30 days after publication in the *Federal Register*.

Principal Changes From the Proposed Rules and Supplemental Proposed Rules

The Final Rules differ from the proposed amendments² and supplemental amendments,³ published in the *Federal Register* on June 12, 2020 and September 24, 2020, respectively, in a few key respects. In particular, the Final Rules clarify in CFTC Rule 190.11 that if a debtor clearing organization is organized outside the United States, then only selected provisions in Part 190 of the CFTC’s regulations would apply, including (1) the general provisions in Subpart A to Part 190; (2) the reports and records requirements in CFTC Rule 190.12; and (3) the prohibition on avoidance of transfers in Rule 190.13 and the net equity calculation and treatment of property requirements in Rules 190.17 and 190.18, but only with respect to an FCM clearing member’s public customers. The CFTC expressed its rationale in adopting the final scheme as a balance between protecting customers and mitigating conflict with foreign proceedings.

Additionally, the CFTC adopted a simplified CFTC Rule 190.14(b) that is consistent with DCO rules governing the default of the DCO. As originally proposed, Rule 190.14(b) included additional provisions that were intended to provide a brief opportunity, after the order for relief, to enable alternatives (i.e., resolution under Title II of the Dodd–Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) or the transfer of clearing operations to another DCO) in lieu of liquidation. In response to comments following the Proposed Rules, the CFTC withdrew proposed paragraphs (b)(2) and (b)(3) and issued the Supplemental Proposed Rules with an alternative approach to facilitate the potential resolution of a systemically important DCO under Title II of the Dodd-Frank Act. In adopting the Final Rules, the CFTC determined not to go forward with the Supplemental Proposed Rules. As adopted, Rule 190.14(b) provides only that subsequent to the order for relief, the DCO must cease making calls for variation settlement or initial margin. Relatedly, former Chairman Heath Tarbert noted that the CFTC will engage in “further analysis and development before proposing this, or any other, alternative approach.”

Katten’s prior advisory, “[More Than a Refresh but Much Less Than A Substantial Overhaul: The CFTC Proposes Comprehensive Amendments to Its Bankruptcy Rules](#),” includes a discussion of the Proposed Rules.

See the [CFTC’s Supplemental Proposed Rules](#).

² 85 Fed. Reg. 36000 (June 12, 2020) (the “Proposed Rules”).

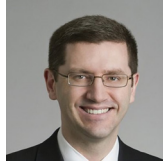
³ 85 Fed. Reg. 60110 (Sept. 24, 2020) (the “Supplemental Proposed Rules”).

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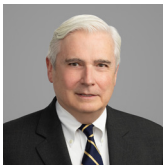
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Appendix

Chart Summarizing Changes to Part 190 of CFTC Regulations

Section	Subject	Change	Key Changes from Current Rules
190.00	Statutory Authority, Organization, Core Concepts, Scope, and Construction	Section 190.00 sets out the statutory authority, organization, core concepts, scope, and rules of construction for part 190. Section 190.00 serves as a reference guide for the CFTC's intent in bankruptcies, clarifying past issues where the CFTC believes its intent has been misconstrued. Section 190.00 provides notable examples of the requirement of pro rata distribution in response to situations where customers have posted letters of credit to avoid pro rata treatment in a shortfall and clarifying that equitable trusts will not be an available remedy.	New addition.
190.00(c)(3)(i)(C)	Statutory Authority, Organization, Core Concepts, Scope, and Construction	Where a provision in part 190 affords the trustee discretion, that discretion should be exercised in a manner that the trustee determines will best achieve the overarching goal of protecting public customers as a class by enhancing recoveries for, and mitigating disruptions to, public customers as a class.	Clarifies what efforts a trustee must exercise with respect to other requirements.
190.00(d)(3)(v)	Statutory Authority, Organization, Core Concepts, Scope, and Construction	Clarifying that mixed swaps (as defined in 1a(47)(D) of the Act) can be commodity contracts subject to part 190.	Clarification.
190.01	Account Class	Expands definitions of account classes. Noting that "delivery account" applies to each of public and non-public customers, considered separately.	Expanded definition.

Section	Subject	Change	Key Changes from Current Rules
190.01	Cash Delivery Property	Means any cash or cash equivalents recorded in a delivery account that is, as of the filing date: (1) credited to such account to pay for receipt of delivery of a commodity under a commodity contract; (2) credited to such account to collateralize or guarantee an obligation to make or take delivery of a commodity under a commodity contract; or (3) has been credited to such account as payment received in exchange for making delivery of a commodity under a commodity contract. It includes property in the form of commodities that have been delivered after the filing date in exchange for cash or cash equivalents held in a delivery account as of the filing date. The definition also requires that the cash or cash equivalents, or the commodity, must be identified on the books and the records of the debtor as having been received, from or for the account of a particular customer, on or after seven calendar days before the relevant (a) first delivery notice date in the case of a futures contract; or (b) exercise date in the case of a cleared option.	Expanded definition, changes three calendar days period to seven calendar days, makes explicit that applies to cash transferred from a customer to the trustee after the filing date.
190.01	Physical Delivery	Expands definition to recognize that intangible commodities that may be physically delivered. Clarifies that for cash delivery property, where one fiat currency is exchanged for another, neither such currency would be considered physical delivery property. In a case where the final settlement price is negative (i.e., where the party obliged to deliver physical delivery property under an expiring futures contract or an expired options contract is also obliged to make a cash payment to the buyer), such cash or cash equivalents constitute physical delivery property.	Expanded definition. Clarification for cash delivery property and negative price events.
190.02(a)(1)	Request for Exemption	Expanded to include any procedural provision rather than limiting to exemption from or extension to a time limit.	May request exemption from any procedure not only time limits.
190.02(f)	Voluntary Petition for Bankruptcy by Receiver	New power that would explicitly permit a receiver to file a voluntary petition for bankruptcy for an FCM in appropriate cases.	New authority to file voluntary petition.
190.02(g)	Voluntary Petition for Bankruptcy by Receiver	Notes that the definition of “allowed” in filing a voluntary petition under Part 190.02 shall have the meaning ascribed to it in the Bankruptcy Code.	Clarification of voluntary petition procedure.

Section	Subject	Change	Key Changes from Current Rules
190.03(a)(1)	Providing Notices	Authorizes notices by electronic mail; no longer required to submit by overnight hard copy.	Removes hard copy requirements.
190.03(a)(2)	General Approach to Notices	Replaces specific procedures with any “reasonably designed” for giving notice.	Change from specific to general approach.
190.03(b)	Notices to CFTC and DSROs	(1) In voluntary bankruptcy, revises time to “as soon as practicable, and in any event no later than the time of filing;” (2) in involuntary filings, must notify immediately; (3) must provide docket number “as soon as known;” (4) must notify the CFTC of intent to transfer open commodity contracts as soon as possible.	Removes three-day deadline for intent to transfer. Includes revised notice requirements.
190.03(c)	Notices to Customers	Changes notice standard to “all reasonable efforts.” Trustee may then liquidate on the seventh day after the order for relief if the customer has not instructed the trustee in writing before the deadline specified in the notice to return property.	Removes requirement to publish in newspaper, removes the sixth calendar day following second publication requirement.
190.03(c)(2)	Open Commodity Contracts in Hedging Accounts	(1) Trustee given authority as an option but not an obligation to treat open commodity contracts of public customers held in hedging accounts designated as such in the debtor’s records as specifically identifiable property after consulting with the CFTC and when practical under the circumstances; (2) if trustee exercises this option then trustee must notify each relevant customer and request instructions whether to transfer or liquidate the relevant open commodity contracts; (3) trustee must inform customer that if instructions are not given the contracts will not be treated as specifically identifiable property.	Changes from bespoke basis to categorical basis.
190(c)(2)(ii)(B)	Open Commodity Contracts in Hedging Accounts	Clarifies that Trustee may follow previous public customer instructions: (1) where, in the judgment of the trustee, the books and records of the debtor reveal a clear preference by a relevant public customer with respect to transfer or liquidation of open commodity contracts, the trustee shall endeavor, to the extent reasonably practicable, to comply with that preference; and (2) where, in the judgment of the trustee, the books and records of the debtor do not reveal a clear preference by a relevant public customer with respect to transfer or liquidation of open commodity contracts, the trustee will request the customer to provide written instructions whether to transfer or liquidate such open commodity contracts. Such notice must specify the manner for providing such instructions and the deadline by which the customer must provide instructions.	Additional clarification of requirements of trustee to follow public customer instructions.

Section	Subject	Change	Key Changes from Current Rules
190.03(e) & (f)	Proof of Customer Claim	Allows for trustee discretion to adapt a request for certain information to the facts of a particular case. CFTC has included a revised template form, but notes that it is within trustee's discretion whether to use form.	Deletes question on if claimant is an "affiliate" "insider" or "relative."
190.04(a)	Transfer of Open Contracts	(1) Changes "must immediately" standard to "shall promptly;" (2) retains provision that if a commodity broker demonstrates to the CFTC in a specified period of time that it is in compliance with segregation and financial requirements on the filing date, the CFTC may determine to allow the commodity broker to continue in business.	Increase in discretion.
190.04(b)	Margin Payments	(1) Expansion of payment of margin payments from only "pending liquidation" to "pending transfer or liquidation;" (2) may not make payments on behalf of any commodity contract account that is in deficit; (3) FCMs or clearing organizations may exercise contractual rights based on upstream collateral, but not if an upstream margin payment would exceed the funded balance of the account; (4) trustee may but is no longer required to make margin calls for public customers; (5) a trustee must liquidate as soon as practicable all open commodity contract accounts in any commodity account (a) that is in deficit; (b) for which mark-to-market calculation would result in a deficit; (c) for which the customer fails to meet a margin call made by the trustee in a reasonable time (an hour or such greater period not to exceed one business day at trustee discretion).	May make margin payments pending transfer. Expands liquidation requirements for accounts that are in deficit.
190.04(b)(5)	Assigning Liquidating Positions in Omnibus Account	Trustee should liquidate accounts in risk-reducing manner based on the customer account as a whole.	Increase in trustee discretion.
190.04(c)	Best Efforts to Avoid Delivery	Makes explicit current approach to liquidate promptly commodity contracts that are not settled in cash and are moving into the delivery period.	Clarification of CFTC policy.
190.04(d)	Liquidation of Specifically Identifiable Property	(1) Applies to specifically identifiable property other than open commodity contracts or physical delivery property; (2) must liquidate if drops below 75 percent of fair market value or if failure to liquidate may result in a deficit balance.	Changes benchmark for liquidation from 90 percent fair market value (FMV) to 75 percent FMV. Clarifies existing requirement that liquidation be "in an orderly manner."

Section	Subject	Change	Key Changes from Current Rules
190.04(d)(3)	Customer Letters of Credit	Trustee may request that a customer deliver substitute customer property with respect to any letter of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract; amount may be less than face value at trustee's discretion. Any portion of the letter of credit not fully drawn upon will count as having been distributed to customer.	Expanded treatment for letters of credit.
190.04(d)(3)(iv)	Customer Letters of Credit	The trustee shall, in exercising their discretion with regard to addressing letters of credit, including as to the timing and amount of a request for substitute customer property, endeavor to mitigate, to the extent practicable, the adverse effects upon customers that have posted letters of credit in a manner that achieves pro rata treatment among customer claims	Clarifies trustee discretion in drawing on letters of credit.
190.04(e)(1)(i) & (2)	Approval of Clearing Organization Rules	Deletes requirement for CFTC preapproval of rules regarding liquidation of open commodity contracts.	Removes pre-approval requirement.
190.04(e)(1)(ii)	Non-DCO or Foreign Clearing Member Debtor	Trustee "shall use commercially reasonable efforts to liquidate open commodity contracts."	Increase in trustee discretion.
190.04(e)(3)	FCM or foreign futures intermediary Upstream Rights	Confirms that upstream intermediaries may exercise contractual rights.	Clarification of CFTC policy.
190.05(a) & (b)	Compliance with CEA & Funded Balance Computations	Provides flexibility to trustee by changing standard of compliance to "shall use reasonable efforts to comply" and shall use "reasonable efforts" to compute customer accounts balance until the open commodity contracts and other property in the account have been transferred or liquidated.	Shifts from mandatory to reasonable efforts standard, limits how long must compute account balances.
190.05(c)(1)	Records Retention	Changes period of retention to "until such time as the debtor's case is closed."	Reduced requirement.
190.05(d)	Account Statements	Trustee must use all reasonable efforts to continue to issue account statements.	New requirement.
190.05(f)	Residual Interest Provisions	Trustee must apply residual interest provisions in a manner appropriate.	New requirement.
190.06	Making and Taking Delivery under Commodity Contracts	Trustee may use reasonable efforts to permit relevant customer to make or take delivery outside the administration of the debtor's estate.	New requirement.
190.07(a)(3)	Transfers	No clearing organization or other self regulatory organization may adopt, maintain in effect, or enforce rules that prevent the acceptance by its members of transfers of open commodity contracts and the equity margining or securing of such contracts from FCMs if the CFTC has approved the transfer.	Changes from "interfere with" to prevent the creation of an active obligation.

Section	Subject	Change	Key Changes from Current Rules
190.07(b)(3)	Transfer of Accounts	Transferee may accept open commodity contracts and property and may open accounts on its records prior to completing customer diligence provided that account opening diligence as required is performed as soon as practicable but no later than six months after transfer unless extended by the CFTC.	Reduced requirement.
190.07(d)(4)	Separation of Physical Property and Deliverable Positions	Trustee must use reasonable efforts to prevent physical delivery property from being separated from commodity contract positions under which the property is deliverable.	New requirement.
190.08(b)(1)(ii)(A)(4)	Letters of Credit in Calculation of Allowed Net Equity	Face amount of any letter of credit received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract as part of the posting customer's ledger balance.	Expanded treatment for letters of credit.
190.08(d)(1)(i)	Timing for Valuation of Transferred Contract	Changes date for valuation to end of the last settlement cycle on the day proceeding the transfer.	Changes date for clarification.
190.08(d)(1)(ii)(A)	Weighted Average of Liquidation Prices	Trustee may use the weighted average of liquidation prices of identical commodity contracts liquidated within a 24-hour period or business day.	Expands definition of time period.
190.08(d)(1)(ii)(B)	Liquation in Bulk Auctions	Valued at settlement price calculated by the clearing organization as of the end of the settlement cycle during which the commodity contract was liquidated.	Clarification of calculation.
190.09	Segregation of Customer Funds and Distribution of Customer Property	Trustees must fulfill FCM obligation to put certain funds into segregation on behalf of customers where FCMs have not using the current assets of the debtor. Following SIPA, the CFTC states that any securities customer property that remains after satisfaction in full of securities claims provided for in that section of SIPA proceedings become property of the general estate and become customer property in the FCM bankruptcy proceeding. The CFTC rules allow customers to buy back identifiable property to enable pro rata distribution. The final rule clarifies what will constitute "customer property."	Additional trustee ability.

Section	Subject	Change	Key Changes from Current Rules
190.10(d)	Acceptance of Letters of Credit	(1) For a FCM to accept a letter of credit at any point, the letter of credit must be available for the trustee to draw upon, in full or in part, in the event of a bankruptcy proceeding, the entry of a protective decree under SIPA or the appointment of FDIC as a receiver; (2) if the letter of credit is permitted to be and is passed through a clearing organization, the bankruptcy trustee for such clearing organization or FDIC must be able to draw upon the letter of credit in the above situations.	Applies only to new letters of credits, with requirement to transition of one year from effective date. Moved to CFTC Part 1 Regulations.
190.10(a)	FCM Current Accounts Records	Must maintain records of customer accounts and store in a way that can be provided to another FCM in connection with the transfer of open customer contracts of other customer property.	New requirement, moved to CFTC Part 1 Regulations.
190.10(b)	Designation of Hedging Accounts	FCMs are required to provide customers an opportunity to designate an account as a hedging account when the customer first opens the account. Clients can make a representation to FCM to have current account designated as a hedging account.	New requirement, moved to CFTC Part 1 Regulations.
190.10(c)	Designation of Delivery Accounts	When a FCM facilitates delivery under a customer's physical delivery contract, and such delivery is effected outside of a futures account, foreign futures account, or cleared swaps account, it must be effected through (and the associated property held in) a delivery account.	New requirement, moved to CFTC Part 1 Regulations.
190.11	Bankruptcy of Clearing Organization	Establishes bespoke rules that apply to clearing organizations. Notes that where a debtor clearing organization is organized outside the United States, §§ 190.13, 190.17 and 190.18 would only apply with respect to: (1) claims of FCM clearing members on behalf of their public customers; and (2) property that is or should have been segregated for the benefit of FCM clearing members' public customers, or that has been recovered for the benefit of FCM clearing members' public customers.	New regime.
190.12(a)(2)	Notice of Clearing Organization Bankruptcy	Must notify in advance of or in time of filing a petition voluntarily, or within three hours if involuntarily. Clearing organization must be prepared to give trustee copies of each of the most recent reports filed with the CFTC under 39.19(c) (1),(2),(3) and 39.39(b) within three hours or as soon as practicable.	New requirement.
190.13	DCO Transfers	DCO transfers require explicit CFTC approval.	New requirement.

Section	Subject	Change	Key Changes from Current Rules
190.14(b)	Continued Operation	Discusses the operation of a debtor clearing organization in bankruptcy and provides that, after the order for relief, the DCO shall cease making calls for either variation or initial margin.	Affirmation of status quo.
190.14(c)(1)	Liquidation of All Open Commodity Contracts	Must be liquidated within seven days of relief unless the CFTC determines otherwise.	New requirement.
190.15	DCO Rules for Insolvency	Trustee may implement DCOs must rules and procedures regarding insolvency and default adopted under 39.16 and 39.35.	New requirement.
190.16(a)	Delivery	Instructs the trustee to use reasonable efforts to facilitate and cooperate with completion of delivery in a manner consistent with § 190.16(a) (which instructs trustees of FCMs in bankruptcy to foster delivery where a contract has entered delivery phase before the filing date or where it is not practicable for the trustee to liquidate a contract moving into delivery position after the filing date)	New requirement.
190.17(b)(2)	Allocation of Members Recovery	DCOs must adjust members' net equity claims in reverse order of the allocation of losses. Notes that it is appropriate to use "reverse the waterfall" rules for recoveries made by a clearing organization (including a debtor clearing organization).	New requirement.
190.18	Scope of Customer Property for DCOs	Follows approach of 190.09 FCM property. DCOs include as customer property any guarantee fund deposit, assessment or similar payment or deposits made by a member, to the extent any remains following the administration of the debtor's default rules and procedures.	New requirement.
190.18(b)(1)	Scope of Customer Property for DCOs	Makes explicit that customer property includes the amounts of its own funds that a debtor DCO had committed as part of its loss allocation rules.	New requirement.
190.19	Use of Daily Settlement	Resources that are intended to flow through to members as part of daily settlement (including both daily variation payments and default resources) should be devoted to that purpose, rather than to the general estate.	New requirement.